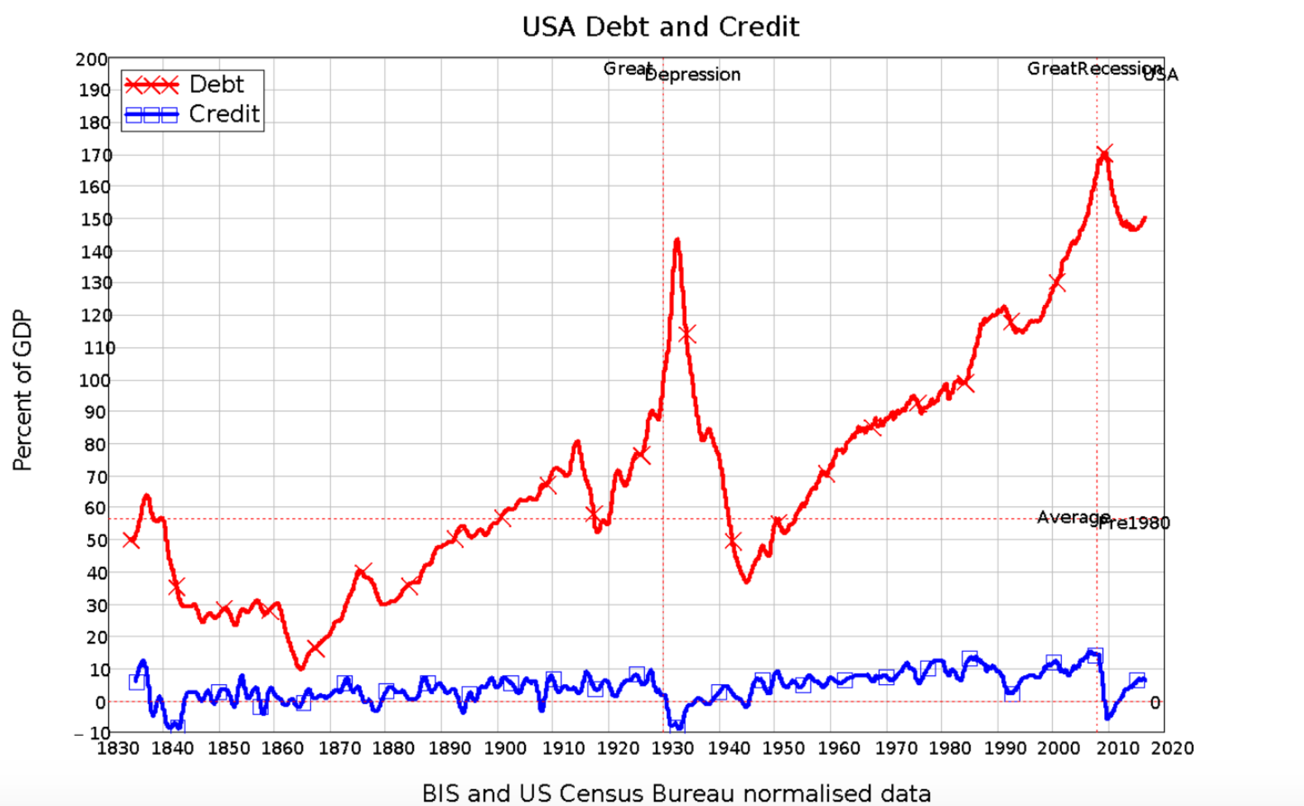
ONE CANNOT LIVE BY DEBT ALONE

DON'S BLOG 2017.09.26

Well, the Fed met and the decision on policy was approximately what the market expected—no rate increase and the commencing of a reduction in their $4 trillion plus portfolio. I had expected them to wait until the first of the new year for the start of the reduction, but instead it will begin in October. The signal I get from this is that slowly, but surely, stimulus from monetary policy and thus liquidity is being withdrawn, leaving the market and economy to fend and fund for themselves. This is bullish for the long-term government interest rates and somewhat bearish for everything else. One can certainly argue as to when this will be reflected in the marketplace. It's counterintuitive, however supply demand charts many times can be wrong when the big picture overrides.

Last week, I posted a Steve Keen chart entitled USA Private Debt and Credit (see below).



This is, without a doubt, the most important chart developed by anyone in the economic community. I had several calls last week concerning this as I did a very poor job of explaining its significance. First of all, please note it's private debt only. Keen excludes federal public debt because they have a printing press and they don't need to come out even at the end of the day (as do we). I reluctantly buy into that even though it goes against my Libertarian beliefs. "Deficits don't matter anymore" which is the war cry of both sides of the aisle; which in my opinion, causes all types of moral hazards and economic inefficiency, but does not seriously damage the business cycle. The only caveat is that when such socialist spending leads to authoritarianism—which in turn leads to loss of economic freedom—confidence fails a la Venezuela. This is when the gold bugs win and Weimer Republic-type inflation sets in. It's all guess work, but I would suggest we are at least 100 years away from it coming to our shores.

Back to the chart, please note the red line which reflects the buildup of private debt since 1920. It was this buildup in the 1920s which caused the 1930s Great Depression. Period, end of comment. Only the Austrian economic model understands this, and such scholars as Milton Friedman and Ben Bernanke—as well as many others—got it wrong.

Somewhere around 1945 the percentages of private debt to GDP started to grown again. GDP went up about in line with debt growth, therefore no major problems occurred until the mid-1980s; and if you will note the blue line started to grow much faster than GDP, something like 10% versus 3.5%. Thus, a new 1920s experience commenced. This debt buildup between 1985 and 2007 brought on what I consider the second Great Depression in sheep's clothing, but is called the Great Recession.

As mentioned in last week's blog, my mistake in calling for a recession every year for the last several years is reflected in the red line, which has been declining, and the blue line doing likewise. However, please note both are again growing. Debt growth of 5% is greater than 2% real GDP so once again we are off to the races. When will the debt burden result in another recession? I really don't know but it's baked in the pie. One cannot live by debt alone.

The good old days cannot return in any meaningful way until private debt gets eliminated in some manner. Steve Keen says a biblical debt jubilee will do it, and frankly I have no real good idea. I'm still looking for a solution.